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June 1, 2009

VIA ELECTRONIC MAIL

Comments on Draft Guidelines
c/o Division of Local Finance
1700 James K. Polk State Office Building
505 Deaderick Street
Nashville, TN 37243-1402

**Re: Comments on Draft Guidelines on Interest Rate and Forward
Purchase Agreements**

Dear Sir or Madam:

Please accept this letter as the comments of our firm on the draft Guidelines on Interest Rate and Forward Purchase Agreements that were disseminated on May 1, 2009 (the "Proposed Guidelines"). We greatly appreciate the opportunity to comment on the Proposed Guidelines, and we would be glad to discuss any of our comments with you in further detail if that would be helpful to you. Capitalized terms used in these comments and not otherwise defined have the meanings given to such terms in the Proposed Guidelines.

General Comments

Before offering comments on specific provisions of the Proposed Guidelines, we first offer some general conceptual comments. First, we would recommend that the Proposed Guidelines address specifically the relationship of the Proposed Guidelines to Interest Rate Agreements that have already been executed or that have already been approved under the existing Guidelines. As we read the Proposed Guidelines, their provisions, including the reporting requirements, would only apply to Interest Rate Agreements that are approved under the Proposed Guidelines. However, to avoid any ambiguity on this point, we would encourage you to specifically address this issue in the Proposed Guidelines.

Our second general comment relates to the requirement in the Proposed Guidelines that a conduit issuer and a borrower from a conduit issuer each meet the requirements of the Proposed Guidelines separately (Section III.A of the Proposed Guidelines). As your office is aware, most variable rate debt in Tennessee that is issued for the benefit of municipal entities is issued

through public building authorities and therefore a conduit issuer is utilized. Because this is the case, many of the Interest Rate Agreements relating to variable rate debt of municipalities that have been executed in Tennessee hedge bonds issued by public building authority at the request of a municipal entity. Some of these Interest Rate Agreements are entered into by the public building authority, and the conduit municipal borrower agrees to pay any swap payments for which the public building authority is responsible under the borrower's loan agreement with the public building authority. In such a case, the public building authority's obligation with respect to the Interest Rate Agreement is limited to the payments that the public building authority receives from the borrower, and the public building authority has no direct financial liability for such payments. Given that public building authorities have no real financial exposure for such an Interest Rate Agreement, we would recommend that the Proposed Guidelines focus on the conduit borrower and not the conduit issuer (as long as the conduit issuer's liability is limited to the payments that it receives from the conduit borrower). Moreover, as public building authorities generally have no employees, and certainly would not have the staff required by the Proposed Guidelines, the requirement in the Proposed Guidelines that conduit issuers meet the Proposed Guidelines separately for an Interest Rate Agreement would effectively foreclose the use of Interest Rate Agreements in these circumstances for even the most sophisticated municipal borrowers. Given that a substantial amount of variable rate debt has already been incurred by Governmental Entities through public building authorities, with the expectation that an interest rate swap would be a potential alternative for hedging interest rates in the future, we would encourage you to reconsider the requirement that a conduit issuer separately meet all requirements of the Proposed Guidelines in cases where the conduit issuer has no financial exposure for the interest rate swap payments.

Third, there is a new limitation in the Proposed Guidelines with respect to Interest Rate Agreements as to which we would encourage you to get further input from the investment banking community, including independent swap consultants. That limitation is the requirement that the Interest Rate Agreement result in a decrease of at least 100 basis points from actual fixed rates for a variable to fixed rate swap (contained in Section IV.A.4 of the Proposed Guidelines). It is our experience that this limitation could effectively prohibit the use of Interest Rate Agreements in most, if not all, circumstances. While we would agree that it is very important for a municipality to compare the benefits of savings from an Interest Rate Agreement with the risks inherent with an Interest Rate Agreement, we would encourage you to consider whether a minimum savings amount should be required. Because this is an economic, and not legal, issue, we would hope that you would gather more information from other market participants on this question.

Specific Comments

1. **Definitions of "Accountant" and "Chief Financial Officer."** We would suggest that you give the full names for the acronyms CM FO, CGFM, CPFO and CPA. While these acronyms may be widely know in the governmental accounting community, the public may not be as informed as to the meaning of these terms.

2. **Definition of "Independent Swap Advisor."** The proposed definition provides that an entity will qualify as an Independent Swap Advisor if it "only provides advisory services with

proven experience in the area of derivative transaction for issuers of debt." We found this definition to be somewhat confusing as it is unclear whether an entity qualifies if it is only providing swap consulting services to the Governmental Entity in question or only if the entity's sole line of business is swap consulting services. There are a number of outstanding financial advisory firms that provide swap consulting services that also provide consulting services on structuring municipal finance transactions generally or structuring investment portfolios, particularly defeasance escrows. We would recommend that these entities not be disqualified from serving as Independent Swap Advisors as long as the entity in question is not serving in another role in the transaction in question. Otherwise, some very well qualified firms would be unavailable to assist municipalities in the State.

3. Definition of "Independent Swap Advisor" and "Independent Swap Counsel."

In both of these definitions, an Independent Swap Advisor and Independent Swap Counsel are required to disclose "any other actions brought against it." This requirement, particularly as to large national law firms that often serve as counsel on swap transactions, would require disclosure about claims totally unrelated to municipal transactions and which may have no merit. This requirement could strongly discourage very qualified firms from accepting these engagements. We would recommend that this disclosure be limited to actions related to the interest rate or other hedging transactions.

4. Definition of "Independent Swap Counsel." This definition requires Independent Swap Counsel to have a "fiduciary duty" strictly to the Governmental Entity. Under applicable ethical rules, a law firm has a client relationship that is governed by those ethical rules, and not a fiduciary relationship. We would recommend that this language be reworded to provide that Independent Swap Counsel's sole client relationship in a transaction under applicable ethical rules must be with the Governmental Entity and not with any other party involved in the transaction. The Independent Swap Counsel should enter into an engagement letter to that effect. This comment would also apply to Section IV.A.3.b.

5. Section III.D.1. This provision provides that an Interest Rate Agreement cannot be used in connection with financing that does not have level debt service. We think that the issue of whether debt can be "back loaded" is a separate issue that does not particularly relate to Interest Rate Agreements and that this issue should be addressed in separate debt management policies. A Governmental Entity may have very legitimate reasons for structuring its debt service in a particular transaction in a manner that does not result in level debt service. For example, a Governmental Entity may want to provide financing for a project by issuing short-term fixed rate debt to finance a portion of the project costs to take advantage of lower yields on short-term debt at a time that may not be opportune to issue long-term fixed rate debt. That Governmental Entity may want to wrap this short-term debt with long-term variable rate debt in a separate transaction to provide the remainder of the financing for the project, which debt would not have level debt service. A number of other legitimate circumstances can arise under which it would be in the best interests of the Governmental Entity to issue debt that does not have level debt service. For these reasons, we would recommend that the issue of back-loaded debt be addressed in model debt management policies and not interest rate swap guidelines.

6. **Section III.D.5.** This section requires a Governmental Entity that utilizes an Interest Rate Agreement to have adopted "enforceable" debt and derivative management policies. Policies are not technically enforceable by third parties as they can generally be amended or waived by the Governmental Entity that adopts the policies. We would recommend that the reference to "enforceable" be deleted. This section also requires that these policies meet the standard of model finance transaction management policies development by the State Funding Board under Tenn. Code Ann. Section 9-21-151. We are not familiar with these policies and wanted to confirm that this reference was correct.

7. **Section III.G.1.** This section requires a Governmental Entity to submit a copy of the ISDA master agreement with "Interest Rate Agreement memo identifying the transaction." The ISDA master agreement itself will not contain the terms of the transaction, so we would recommend that the filing also include drafts of the associated Schedule and Confirmation. If a "memo" also needs to be filed, further information should be included as what the "memo" should discuss.

8. **Section III.G.2.** We would recommend that this Section be deleted. The only possible relevance of this Section would relate to the exercise of an option to enter into an Interest Rate Agreement or a "swaption." As this type of agreement is specifically prohibited as speculative in Section IV.A.5.h, this Section should not be needed.

9. **Section III.G.3.** This section requires that certain material events be reported to the State Director of Local Finance and appears to be generally modeled after Rule 15c2-12 of the Securities Exchange Commission. The Proposed Guidelines, however, require filings to be made within five business days of certain events. Rule 15c2-12 only requires filings to be made in a timely manner. Given that certain of the material events are beyond the control of the Governmental Entity, and the Governmental Entity may not be aware that an event may have occurred for some time, the requirement that notice be given in a timely manner, as provided in Rule 15c2-12, would be a preferable approach. Moreover, this approach would avoid Governmental Entities having to comply with multiple filing deadlines.

10. **Section III.G.5.** This Section requires the filing of certain annual reports. We would recommend that the dates in this Section be changed to provide that the reports will be filed within a certain number of months of the end of each Governmental Entity's fiscal year. Not all Governmental Entities that would be subject to the Proposed Guidelines are required to have a fiscal year that ends on June 30, which appears to be what this Section assumes.

11. **Section III.G.6.** We would recommend that this Section include language to clarify whether the transfer of an Interest Rate Agreement from one counterparty to another (sometimes called a novation) would constitute a termination of an interest rate agreement.

12. **Section IV.A.1.** We are unsure whether this provision was intended to require a Governmental Entity to have at least \$50,000,000 in debt outstanding in order to enter into an interest rate agreement or whether the interest rate agreement must relate to at least \$50,000,000 of debt. A clarification on this issue would be helpful.

13. **Section IV.A.3 and Section IV.B.** These two sections would appear to require a Governmental Entity to retain two independent swap advisors for each transaction. The cost of doing so would be fairly burdensome to a Governmental Entity. If the swap advisor retained by the Governmental Entity is truly independent, we do not understand that benefit of retaining two swap advisors and would encourage you to reconsider this approach.

14. **Section IV.A.4.a.2.** This Section essentially requires debt that is swapped to a variable rate to be hedged by short-term investments adequate to pay debt service on the hedged debt. Given the likelihood that such an approach would be impermissible under applicable federal regulations relating to arbitrage, we would suggest that such a requirement not be included. The same language appears in Section IV.A.4.b.2.

15. **Section IV.A.5.b.** We would encourage you to solicit further input from market participants on the five-year limitation in this Section. It is our understanding that there may be a number of circumstances where a Governmental Entity would have legitimate reasons to want a longer term on an Interest Rate Agreement, particularly an interest rate cap or collar.

16. **Section IV.A.5.d.** It is our understanding that the termination value of an Interest Rate Agreement even on the execution date is not exactly \$0 due to transactional costs of executing the agreement. We would recommend that you confirm with experts on this issue as to whether this is correct. If it is, a modest termination value should be permitted upon execution.

17. **Section IV.A.5.h.** This provision essentially prohibits fixed rate to variable rate swaps, but there are other provisions in the Proposed Guidelines (see Section IV.A.4) that appear to permit such swaps. We would recommend that this inconsistency be reconciled. This provision also would prohibit "swaptions." We would recommend that the term "swaption" be defined to clarify whether a forward dated swap is still permitted.

18. **Section IV.D.** This provision requires a Governmental Entity to use standard ISDA documentation for an Interest Rate Agreement, including a Schedule and Confirm. Similar language is included in the existing Guidelines. Technically, a Schedule and Confirmation are not standard ISDA documents and are specifically drafted for each transaction. We would recommend that this language be amended to provide that the standard ISDA master agreement would be used together with a Schedule and Confirmation meeting the requirements of the Proposed Guidelines. Given that the Proposed Guidelines now require approval of the relevant documentation, this approach should be workable.

19. **Section IV.F.** This Section requires Counterparties to have a rating of at least "AA" but also requires guarantors or other sureties to have a "AAA" rating. We do not understand why there would need to be different rating criteria for these types of entities.

20. **Section IV.G.** We would appreciate clarification as to whether the second paragraph of this Section would require an Interest Rate Agreement to be terminated if a bond insurer's rating was downgraded. The second sentence of this paragraph infers that this would not be an automatic termination event, while the first sentence suggests that the rating must be maintained

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at a "AAA" level for the Interest Rate Agreement to remain in effect. Also, the collateralization requirements in this Section may be very difficult to meet. Our experience is that collateral is not typically required unless counterparty's rating is somewhat lower than "AA." We would encourage you to get more input from market participants on this issue.

21. **Section IV.H.** We would recommend that the introductory clause to this Section be deleted. The Governmental Entity should receive mark-to-market calculations even if the Interest Rate Agreement is collateralized so that the Governmental Entity can monitor compliance with the collateral requirements.

We also had a few relatively minor technical comments that we have marked on a copy of the Proposed Guidelines, which marked-up copy is attached. We would also note that the existing Appendix A will need to be modified considerably to be consistent with the Proposed Guidelines, and we assume a revised version of that Appendix will be circulated at a later date.

Again, we appreciate the opportunity to comment on the Proposed Guidelines, and we look forward to continue to work with your office in implementing one of the most comprehensive governmental oversight programs of derivative products for municipal entities in the country.

Sincerely yours,

BASS, BERRY & SIMS PLC

By: 

GMM:cbp
Enclosure

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GUIDELINES FOR INTEREST RATE AND FORWARD PURCHASE AGREEMENTS

I. BACKGROUND

State statutes direct the State Funding Board to establish guidelines, rules or regulations with respect to interest rate swap agreements, other interest rate hedging agreements and forward purchase agreements that may be entered into by certain local governmental entities. State statutes require that if such a Governmental Entity intends to enter into such an agreement and submits such a request, the Comptroller is required to determine whether the proposed agreement complies with the Guidelines and to report thereon to the Governmental Entity. A Governmental Entity must request the report of the Comptroller prior to the adoption by the Governing Body of a resolution authorizing such agreements. The Guidelines are set forth below.

The Guidelines do not govern contracts or other investment agreements based on statutes other than the Forward Purchase Authorizing Statutes or the Interest Rate Authorizing Statutes, whether or not they relate to the Governmental Entity's debt. Even the simplest Interest Rate Agreement is a highly complex financial instrument that requires a high level of financial sophistication and the ability to maintain that level of sophistication for the duration of any derivative instrument. It is the responsibility of the Governmental Entity and its officials to insure they possess the skill and knowledge to execute and maintain an Interest Rate Agreement over its entire life.

The Guidelines do not relate to the appropriateness of the transaction or the legal authority of the Governmental Entity to enter into the Interest Rate or Forward Purchase Agreement. It is the Governmental Entity's responsibility to determine the appropriateness of the transactions and the legal authority to enter into the Agreement. The decision to enter into the Agreement is strictly the decision of the Governmental Entity's CEO and Governing Body.

II. DEFINITIONS

"Accountant" shall mean a professional staff member of the Governmental Entity possessing at least a bachelor's degree or higher in accounting or other bachelor's degree or higher licensed as a Tennessee CPA. This person shall be able to prepare independently US Governmental Generally Accepted Accounting Principles compliant financial statements with complete debt and derivative disclosures.

"Authorizing Statutes" shall mean the Forward Purchase Authorizing Statutes and Interest Rate Authorizing Statutes, a list of which is attached as Attachment C.

L Appendix

"Chief Executive Officer" or "CEO" shall mean the chief elected official of the Governmental Entity, or if there is no such elected official, the chairman or presiding officer of the Governing Body of the Governmental Entity.

"Chief Financial Officer" or "CFO" shall mean the Finance Director or other comparable official of the Governmental Entity overseeing the Governmental Entity's financial management specified by either law or charter or by direction of the CEO or Governing Body, who shall either (1) hold certification as a CMFO, or CGFM, or CPFO, or be a CPA with five (5) years of governmental accounting experience with three (3) years in Tennessee; or (2) hold a masters in business administration or a juris doctorate with five (5) years of public finance experience. This person shall be able to understand US Governmental Generally Accepted Accounting Principles compliant financial statements. This person shall be able to understand the monitoring process and provide the Governing Body with guidance concerning an Interest Rate Agreement transaction from the entrance decision, execution, monitoring, and termination decision to the impact on the Governmental Entity's financial condition and position.

"Comptroller" shall mean either the Comptroller, the Office of the Comptroller of the Treasury of the State of Tennessee, or the Comptroller's designee, as appropriate for the context.

"Counterparty" shall mean the party to an Interest Rate Agreement other than the Governmental Entity.

"Debt management report" shall mean a written debt management report of the Governmental Entity as of the end of the fiscal year including, but not limited to, the following:

1. A listing of each outstanding obligation by type and disclosing amount initially authorized, combined interest rate for fixed rate debt, actual basis for variable rate debt, principal and interest payment for the coming budget year, outstanding principal amount at the beginning and end of budget year, and fund of payment;
2. Total amount of debt of the Governmental Entity by fund, by type, and by security;
3. Total amount of variable rate debt of the Governmental Entity with percent of variable rate debt by fund, by type, by security, and by total outstanding debt;
4. Analysis of the effect of rising interest rates on variable rate debt of the Governmental Entity including impact on financial condition and position;
5. Analysis of risk in maintaining variable rate debt on financial condition and position;

6. Analysis of debt portfolio principal and interest payments on next five years projected budgets; and
7. Governmental Entity's documentation of its compliance with its debt policy including all disclosure requirements for the prior fiscal year.

"Derivative management report" shall mean a written report of the Governmental Entity as of the end of the fiscal year that includes, but is not limited to, all of the following:

1. Analysis of the impact of outstanding Interest Rate Agreements on the prior year's financial condition and position of the Governmental Entity;
2. Analysis of the impact of outstanding Interest Rate Agreements payments on the coming budget year with stress testing for risks associated with the Interest Rate Agreements and changes in market conditions;
3. Analysis of the impact of basis risk on transaction;
4. Analysis of early termination, involuntary termination, default, and cost considerations associated with outstanding Interest Rate Agreements;
5. Analysis of hedge effectiveness;
6. Summary of monitoring for all outstanding Interest Rate Agreements in the prior year;
7. Update on method and assumptions for determining market/termination value and any other estimates or rates associated with Interest Rate Agreements; and
8. Governmental Entity's documentation of its compliance with its derivative policy including all disclosure requirements for the prior fiscal year.

"Forward Purchase Agreement" shall mean an agreement providing for the purchase of bonds or other obligations of a Governmental Entity that provides for delivery of such bonds or other obligations on a date greater than ninety (90) days from the date of execution of such agreement.

"Forward Purchase Authorizing Statutes" shall mean the Tennessee legislative acts and statutes authorizing Forward Purchase Agreements in accordance with State Funding Board Guidelines as identified from time to time by the Board and attached as Attachment C.

"Governing Body" shall mean the legislative body of the Governmental Entity.

"Governmental Entity" shall mean any governmental entity authorized to enter into an Interest Rate Agreement or Forward Purchase Agreement pursuant to an Authorizing Statute. In the case of a conduit financing, "Governmental Entity" shall include both the conduit issuer and the borrower.

"Independent Swap Advisor" shall mean an entity that only provides advisory services with proven experience in the area of derivative transactions for issuers of debt. An Independent Swap Advisor's fiduciary duty in the transaction is strictly to the Governmental Entity. In the case of a conduit financing, the conduit

issuer, its staff, consultants and contractors shall not serve as the Independent Swap Advisor to the borrower. The Independent Swap Advisor must disclose all relationships to any participant in the transaction. Additionally, the Independent Swap Advisor must disclose due to its advisory services any investigations it may be a target of, charges brought, convictions or guilty pleas of any key staff, or any other actions brought against it.

"Independent Swap Counsel" shall mean an entity who has legal experience in the area of derivative transactions and whose fiduciary duty in this transaction is strictly to the Governmental Entity. In the case of a conduit financing, the conduit issuer, its staff, consultants and contractors shall not serve as the Independent Swap Counsel to the borrower. Independent Swap Counsel must disclose all relationships to any participant in the transaction. Additionally, Independent Swap Counsel due to its services must disclose any investigations it may be a target of, charges brought, convictions or guilty pleas of any key staff, or any other actions brought against it.

"Interest Rate Agreement" shall mean an interest rate swap or exchange agreement, an agreement establishing an interest rate floor or ceiling or both and any other interest rate hedging agreement, including options to enter into or cancel such agreements, as well as the reversal or extension thereof.

"Interest Rate Authorizing Statutes" shall mean Tennessee legislative acts and statutes authorizing Interest Rate Agreements in accordance with State Funding Board Guidelines as identified from time to time by the Board and attached as Attachment C.

"Monitor" shall mean a professional staff member possessing at least a bachelor's degree or higher in economics, finance, public administration with a concentration in financial management, or accounting being either a Chartered Financial Analyst (CFA), GARP Financial Risk Manager (FRM), PRIMA Professional Risk Manager (PRM™), CGFM, CPA, or CPFO. This staff member shall be able to understand or to prepare and interpret derivative and variable-rate debt monitoring reports and communicate the impact of changes in the derivative or underlying debt on the Governmental Entity's financial condition and operations. This staff member shall be able to prepare US Governmental Generally Accepted Accounting Principles debt and derivatives disclosures.

III. PROCEDURE FOR SUBMISSION AND COMPLIANCE REPORTING

A. Form of Submission.

Any request for a report of compliance with these Guidelines for Interest Rate Agreements or Forward Purchase Agreements shall include such information as is required in these Guidelines and shall be submitted and signed by the Chief Executive Officer (CEO) of the requesting Governmental Entity. For purposes of

either an Interest Rate Agreement or a Forward Purchase Agreement, if a conduit borrowing is involved, both the conduit issuer and the borrower(s) shall separately prepare and submit requests for reports of compliance and separately shall meet all requirements of these Guidelines. Only an independent financial advisor, Independent Swap Advisor, or Independent Swap Counsel may assist the Governmental Entity and its staff in preparing a request, but only the CEO, and no other person or entity, shall submit a request by mail or in any other manner. A request submitted by other than the Chief Executive Officer will not be deemed to have been properly submitted, and the Comptroller shall immediately return the request with an explanation of the proper procedure.

The CEO, the Chief Financial Officer (CFO), the chair of the Governing Body, and the chairs of the finance committee and the audit committee shall review all requests prior to submission to the Comptroller. If the CEO is the chair of the Governing Body, the Governing Body shall appoint another member to review the submission. If there is no finance committee, the Governing Body shall appoint another member to perform a review. If the Governmental Entity has a Municipal or County Manager or Administrator, this employee shall also review the request. The documented reviews, including the reviewers comments, shall be included as part of the request.

The request must supply the information required by the appropriate attached Appendix as specified by these Guidelines, as well as any other information reasonably requested by the Comptroller. The request shall contain the actual signature of the CEO. All communications concerning the request shall be between the Comptroller and the CEO or CFO, if so designated by CEO. A meeting scheduled to approve an Interest Rate or Forward Purchase Agreement by the Governmental Entity cannot be held during the 15-day review period. If the Comptroller is informed a meeting has been scheduled to be held during the review period, the request shall not be deemed to have been received and shall be returned to the Governmental Entity.

B. Acknowledgment by Comptroller.

The Comptroller will record the request on the date received and will issue a timely acknowledgment only to the Chief Executive Officer who submitted the request, indicating the date the request was received and referring to the 15-day period statutory review period. If the request is deemed incomplete after acknowledgement or at time of receipt, the request will not be deemed to have been received and the Comptroller shall inform the Chief Executive Officer that the request was incomplete and identify the item(s) not included. The 15-day statutory review period shall not begin until a complete request is submitted.

C. Identification of Authorizing Statute.

In its request, the Governmental Entity shall identify the Forward Purchase Authorizing Statute or Interest Rate Authorizing Statute under which the request

is being submitted and identify the specific type of Forward Purchase Agreement or Interest Rate Agreement for which the request is being submitted.

D. Conditions for Entering into an Interest Rate or Forward Purchase Agreement.

1. Qualifying Debt Structure:

- a. Qualifying debt shall be structured with at least level debt service. Debt that is determined to be "back loaded" shall not qualify to enter into an interest rate agreement.
- b. Qualifying debt may have an initial construction period of no more than three years matching actual construction time.
- c. Principal payments shall match anticipated available liquidity during the Governmental Entity's fiscal year.

2. The Governmental Entity's financial statements:

- a. The financial statements for the term of the Agreement shall be prepared in compliance with US Governmental Generally Accepted Accounting Principles with an unqualified auditor's opinion. Financial statements for the two fiscal years prior to the request to enter into an Interest Rate Agreement shall have been prepared in compliance with US Governmental Generally Accepted Accounting Principles with an unqualified auditor's opinion.
- b. If the Accountant does not independently prepare the Governmental Entity's financial statements, the Governmental Entity shall have them prepared by a public accountant not its auditor.
- c. A Governmental Entity that uses a public accountant to prepare its financial statements shall explain why the Accountant did not prepare the financial statements.

most recent

for which financial statements have been prepared

3. The Governmental Entity's required minimum number of full-time staff:

- a. Accountant; and
- b. CFO.

4. The Governing Body having an audit committee.

5. Debt Management and Derivative Policies:

- a. The Government Entity by action of its Governing Body shall have adopted appropriate written enforceable debt and derivative management policies meeting the standard of the model finance transaction management policies developed by the State Funding Board under the authority of Tenn. Code Ann. Section 9-21-151.

b. Copies of these policies must be included with a request for a letter of compliance. The Governmental Entity shall include a statement describing how the proposed transaction complies with such policies.

E. Report by Comptroller.

After reviewing the request, the Comptroller shall issue a report, referencing the Forward Purchase Authorizing Statute or Interest Rate Authorizing Statute, stating that the request by the Governmental Entity either substantially complies with these Guidelines or substantially does not comply with these Guidelines. The report stating that a request substantially complies with these Guidelines and the request submitted must be presented to the Governing Body at the time of adoption of the resolution authorizing such Agreement and be included in the record of the meeting.

Any report of the Comptroller relates only to substantial compliance with the Guidelines at the time of the request and does not relate to the appropriateness of the transaction or the legal authority of the Governmental Entity to enter into the Agreement.

If the request does not comply with these Guidelines, the report shall identify the areas of non-compliance. A new request with any areas of non-compliance corrected by the Governmental Entity may be submitted and a new 15-day period for the Comptroller to review the request shall commence on the date of receipt of the complete request.

F. Appeals Process.

If the report of the Comptroller states that the request does not comply with these Guidelines, then the Governmental Entity may file a written request for appeal to the Assistant Secretary of the State Funding Board in the Division of Bond Finance, Office of the Comptroller of the Treasury. Such request shall specify in detail the basis on which the Governmental Entity believes a report of compliance is justified. A meeting of the State Funding Board shall be held to consider the written appeal request within 30 days of receipt of the appeal request, or as soon thereafter as a quorum can be achieved.

G. Reporting.

1. **Execution** – Upon entering into an Interest Rate Agreement, the Governmental Entity shall report the derivative in accordance with the requirements of Tenn. Code Ann. Section 9-21-151 to the State Director of Local Finance no later than 45-days after the execution of the Agreement. The Governmental Entity shall file with the Director a copy of the interest rate (ISDA) master agreement with the Interest Rate Agreement memo identifying the transaction and the reasons for executing

it. The Governmental Entity shall maintain a permanent copy of this report containing the memo and Agreement. If an Interest Rate Agreement is used to create synthetic fixed rate debt, the Government Entity shall be required to provide the ~~average coupon rate~~ it would have paid on a fixed-rate bond issue on the day the Interest Rate Agreement was entered.

estimated
true interest cost

2. Option - The Governmental Entity shall make a report no later than 15-days after the exercise of an option to the State Director of Local Finance. This report will detail the reasons for executing the option, the details of the transaction including any costs related to exercise and the impact on its financial position and operations.

3. Material Events- Upon the occurrence of any of the following as they relate to the Agreement or the identified indebtedness, the Governmental Entity shall within five (5) business days report to the State Director of Local Finance and to the local Governing Body:

- a. Vacancy or change in the position or role of ~~Monitor~~ ^M;
- b. Downgrade in the rating of any party to the Agreement or transaction;
- c. Default in the performance of any party to the Agreement or the transaction, including non-payment related defaults;
- d. Principal and interest payment delinquencies;
- e. Unscheduled draws on debt service reserves reflecting financial difficulties;
- f. Unscheduled draws on credit enhancements reflecting financial difficulties;
- g. Substitution of credit or liquidity providers, or their failure to perform;
- h. Adverse tax opinions or events affecting the tax-exempt status of the security;
- i. Modifications to rights of securities holders;
- j. Bond calls;
- k. Defeasances;
- l. Release, substitution, or sale of property securing repayment of the securities; and
- m. Failure to provide annual financial information as required by these Guidelines, transaction documents, or by law.

4. Quarterly – The Governmental Entity shall submit monthly to the local Governing Body a report documenting its monitoring activities, which report is to be presented at the next meeting of the Governing Body and included the minutes of the meeting. The report shall include any material events affecting the underlying debt or any parties to the

transaction, as well as a status update regarding replacement of any parties. Such reports shall be submitted to the State Director of Local Finance on a quarterly basis.

5. Annually – The Governmental Entity shall submit annually to the local Governing Body and to the State Director of Local Finance:

- a. Debt and Derivative Management Reports as defined in these Guidelines, by January 15 of each year;
- b. Annual Operating and Capital Budget in the manner of Tenn. Code Ann. Section 9-21-403 by August 31 of each year; and
- c. Audited Annual Financial Statements by January 15 of each year.

6. Termination - If the Governmental Entity terminates an Interest Rate Agreement or Forward Purchase Agreement, the Governmental Entity jointly with its Independent Swap Advisor shall submit within 15-days a report to the Comptroller identifying the business purpose for such termination, any payments made or received by any parties to the Agreement, any other costs, and the impact on its financial position and operations. The report must include the methods and underlying assumptions, data used in the actual calculation of the amount of such payments made or received by any parties to the Agreement, and a summary analysis of the transaction and its effectiveness.

All such reports (except for the Termination Report) shall be submitted only by the Governmental Entity's CEO, with preparation assistance from the CFO and staff, Independent Financial or Swap Advisor or Independent Swap Counsel.

The Comptroller may provide additional guidance concerning reporting beyond these Guidelines. The Comptroller may alter these reporting requirements to meet oversight needs and market conditions, including but not limited to addition reports and timing of reports. Such alterations shall be posted on the State Funding Board or Comptroller's website. The Governmental Entity shall be responsible for periodically viewing the website for updates on requirements.

H. Failure to Meet Guidelines.

Any Governmental Entity failing to meet the requirements of the Guidelines, including the reporting requirements of Paragraph G above, shall be placed on a list of Governmental Entities in noncompliance. Those Governmental Entities on the list shall be ineligible to request Letters of Compliance or to enter into any additional Interest Rate or Forward Purchase Agreements, including those for which they have previously received a positive report of compliance but have not yet executed the Agreement. The Governmental Entity may present to the State Funding Board a plan of how it will insure

future compliance with the Guidelines, and the State Funding Board may remove the Governmental Entity from the list of noncompliance.

IV. GUIDELINES SPECIFIC TO INTEREST RATE AGREEMENTS

A. Conditions to Entering into an Interest Rate Agreement

1. Size: Outstanding or to be issued debt with a principal amount of at least \$50,000,000 at the time of execution of the initial Interest Rate Agreement.

2. Type:

a. Variable-rate with the method for determining the variable interest rate and the proposed or actual continuing and one-time costs disclosed.

b. Fixed-rate debt with proposed or actual continuing and one-time costs fully disclosed.

3. Governmental Entity Staffing:

a. The Governmental Entity shall be required, in addition to the Accountant and the CFO, to have a Monitor:

1.) An Independent Swap Advisor not involved with the proposed Interest Rate Agreement shall determine if the monitor has a basic knowledge of derivatives and risks and can explain the proposed Interest Rate Agreement detailing the risks and potential impact on the Governmental Entity's financial position and condition. This determination shall be documented and shall be included with the Application.

2.) An Independent Swap Advisor shall work with the Monitor in planning, designing and execution of the Interest Rate Agreement.

b. Independent Swap Counsel with a fiduciary duty only to the Governmental Entity shall be involved in designing and executing the Governmental Entity's Interest Rate Agreement.

4. Permitted business purposes:

a. With Respect To Outstanding Debt:

1.) Variable-rate debt:

a.) Hedge against increases in the variable-rate paid by the Governmental Entity using an Interest Rate Agreement ~~or using an interest rate cap or collar.~~ ←

b.) Objective is to refund at the lowest possible fixed-rate using Interest Rate Agreements or caps and collars with a decrease of at least 100 basis points between the actual fixed-rate and the synthetic rates without incurring refunding costs.

← estimated

← Already covered in definition.

c.) Calculations shall include the fees associated with variable rate debt as part of the variable rate debt interest cost.

2.) Fixed-Rate Debt: Create synthetic variable-rate debt using an interest agreement that produces a decrease in interest rate payments of at least 200 basis points without paying any refunding costs and has underlying short-term investments that will match the principle amount of the debt to allow asset liability management. The returns on the short-term investments are meant to pay the variable-rate payment.

b. With Respect To New Issue Debt:

1.) Variable-rate debt:

a.) Objective is to borrow at the lowest possible fixed-rate using Interest Rate Agreements or caps and collars with a decrease of at least 100 basis points between the actual fixed-rate and the synthetic rates. *est: match*

b.) Calculations shall include the fees associated with variable rate debt as part of the variable rate debt interest cost.

2.) Fixed-Rate Debt: Create synthetic variable-rate debt using an interest agreement that produces a decrease in interest rate payment of at least 200 basis points without paying any additional variable-rate fees and any continuing fee being significantly less than those for variable-rate debt and has underlying short-term investments that will match the principle amount of the debt to allow asset liability management. The returns on the short-term investments pay the variable-rate payment.

5. General Interest Rate Agreement Requirements

a. No Interest Rate Agreement shall be entered into unless such agreement relates to a specific identifiable indebtedness of the Governmental Entity either (i) that is outstanding or (ii) that will be incurred or authorized contemporaneously with either the execution or effective date of the Interest Rate Agreement and the Agreement is contingent on the issuance of such debt.

b. The Interest Rate Agreement shall have a life no more than five (5) years and shall not extend beyond the life of the indebtedness.

c. The notional amount of the Interest Rate Agreement must reflect the amortization of principal of the related indebtedness.

d. The termination or market value of any Interest rate Agreement entered into with the specified identifiable debt from a request for compliance shall be \$0.00 on the date the interest rate agreement is entered.

- e. Basis risk between actual variable-rate and counter-party's payment rate shall be documentable and verifiable.
- f. The formula used for the payments in a synthetic fixed-rate Interest Rate Agreement can be changed by filing a new request for a report of compliance on the transaction and receiving a positive report of compliance then filing a new Tenn. Code Ann. Section 9-21-151 derivative disclosure.
- g. Only one Interest Rate Agreement can be outstanding at a time for a specific identifiable indebtedness.
- h. No Interest Rate Agreement shall be for speculative reasons, e.g. 1) basis swap: Governmental Entity speculates on its view of the interest rate market by paying the leg of the swap it believes will decrease against receiving the leg it believes will increase; 2) Fixed-to-Variable Swap: Governmental Entity speculates on its view of the interest rate market by swapping into a floating rate it believes will decrease against a fixed rate; 3) Swaption; or 4) Other speculative reasons exist.

B. Supporting Analysis.

A Governmental Entity shall submit an analysis and description of how the Interest Rate Agreement is intended to accomplish its business purpose taking into account the various risks posed by the interest rate agreement and underlying debt. The analysis must support that the potential benefits of the Interest Rate Agreement do the outweigh risks; if not, the request shall not be considered to meet the Guidelines. For a proposed debt issue this analysis shall include a comparison of all alternatives considered by the Governmental Entity and the reasons for the alternative chosen. This analysis shall also include stress testing of the Interest Rate Agreement based on changes in market condition and the risks to support the Governmental Entity is aware of the various risk impact on the Governmental Entity's financial position and condition. The Governmental Entity shall include the impact of its risk management plan on mitigating risks and cost of the plan. The Governmental Entity must produce this analysis themselves; but, an Independent Swap Advisor and Swap Counsel may be used in performing the analysis. The Governmental Entity shall have the analysis reviewed by an Independent Swap Advisor (which is not serving as the Independent Swap Advisor on the transaction for the Governmental Entity) as to the reasonableness of its methodology, assumptions, and conclusions. This independent review shall also report on any risks not reported in the Governmental Entity's analysis and any difference on the conclusion concerning the impact of the Interest Rate Agreement on the Governmental Entity's financial condition and position.

C. Procurement of Interest Rate Agreements.

Governmental Entities may enter into an Interest Rate Agreement through negotiation with a Counterparty or through a competitive bidding process, as provided by law.

D. Form of Documentation.

To document any Interest Rate Agreement, a Governmental Entity shall utilize the standard documentation prepared by the International Swaps and Derivatives Association, Inc. ("ISDA"), such as the Master Agreement, Schedule and Confirmation, with such modifications and supplements as the Governmental Entity deems necessary to accomplish the purposes of the Interest Rate Agreement and as approved by the Comptroller.

E. Risks Associated with Interest Rate Agreements.

Any Governmental Entity proposing to enter into an Interest Rate Agreement shall be responsible for understanding the risks associated with entering into such an Agreement. The Governmental Entity shall identify those risks associated with a proposed Interest Rate Agreement by listing and describing the risks impact in the analysis required to support the accomplishment of the Governmental Entity's business purpose.

F. Standards for Counterparty Selection and Security for Financial Interest.

Except as provided in the next sentence, any Counterparty to an Interest Rate Agreement shall be required to have either a counterparty, a long-term debt, or a claims paying rating at the time the Interest Rate Agreement is entered into of not less than an "AA/P-1" category from a nationally recognized ratings service. In the event a proposed Counterparty does not have or fails to maintain either a counterparty, a long-term debt, or a claims paying rating equal to or higher than an "AA/P-1" category, the Counterparty to the Interest Rate Agreement shall be required to collateralize the termination value of the Interest Rate Agreement with eligible collateral or shall provide a guaranty, surety, or other credit enhancement for its obligations under the Interest Rate Agreement from a guarantor, surety or other credit enhancement provider with a long-term debt or claims paying rating equal to or higher than an "AAA/P-1" category.

Eligible collateral shall mean direct obligations of the United States or any agency thereof. At all times the eligible collateral shall have a market value (as evidenced by weekly valuations required by Section IV-H) at least equal to 102% of the termination value of the Interest Rate Agreement. If collateral is required, the Governing Body shall designate a custodian bank independent of the Counterparty to hold such collateral on behalf of the Governmental Entity.

The custodian bank shall be selected from one of the institutions designated by the State Treasurer of Tennessee as a Trustee Custodian pursuant to Tenn. Code Ann. Section 9-4-108. The Governing Body shall execute a written custodial agreement with the custodian bank to provide for the custody of collateral required from a Counterparty. The custodial agreement shall make specific reference to the applicable Interest Rate Agreement and shall identify the type of collateral that the custodian bank may accept on behalf of the Governmental Entity. The custodial agreement shall also provide that (1) the bank will compare the collateral delivered by the Counterparty to that which has been identified by the Governmental Entity and will accept only such collateral which has been so identified, (2) the bank will certify to the Governmental Entity that such collateral is being held on behalf of the Governmental Entity, (3) the bank will assume entire responsibility for any loss arising from the transfer or safekeeping of such collateral during the period it is held by the bank pursuant to the custodial agreement, except for any loss which may arise from any event determined to be beyond the bank's control, (4) the bank will furnish the Governmental Entity written reports concerning any activity in the custodial account, and (5) no collateral shall be removed from the account without the prior approval of the Governmental Entity.

If the rating of the Guarantor or Surety is lowered below an "AAA/P-1" category or is suspended after an Interest Rate Agreement is entered into, the Counterparty shall be required to collateralize in the manner described above the termination value of the Interest Rate Agreement or provide a substitute entity with a counterparty, a long-term debt, or a claims paying rating equal to or higher than an "AAA/P-1" category within five (5) business days of such downgrade or suspension.

G. Credit Enhancement, Liquidity and Reserves.

The Guidelines do not require, except in those cases where the Counterparty is required to provide collateral, guaranty, surety, or other credit enhancement to secure the termination value of an Interest Rate Agreement, either the Governmental Entity or the Counterparty to obtain credit enhancement or a liquidity facility in connection with entering into an Interest Rate Agreement or to maintain any reserves in connection with such agreement. The guarantor/surety shall have and maintain a rating of not less than "AAA/P-1". The Governmental Entity shall include a plan to replace any guarantor/surety whose rating falls below "AAA/P-1" with and without refunding of the specific identifiable including the cost of terminating the debt with a refunding and costs of replacing the guarantor/surety without a refunding.

If the Governmental Entity uses bond insurance in conjunction with the underlying debt the insurer shall maintain a rating of not less than "AAA/P-1". The analysis of the proposed transaction and derivative shall include the impact of the insurer falling below "AAA/P-1".

H. Financial Monitoring.

Unless the Counterparty has provided collateral to secure its obligations under an Interest Rate Agreement as required by Section IV-F hereof, the Counterparty shall agree to provide the Governmental Entity with at least monthly mark-to-market calculations showing the current termination value of the Interest Rate Agreement. If the Counterparty, Guarantor, or Surety has provided collateral to secure its obligations under an Interest Rate Agreement as required by Section IV-F hereof, the Counterparty shall agree to provide at least weekly valuations of the collateral and the termination value of the Interest Rate Agreement. The Governmental Entity shall establish an independent process for monitoring and reviewing the valuations required by these Guidelines. The Governmental Entity shall clearly describe the process established and shall identify in its request both the Governmental Entity employee designated as the Monitor and the Independent Swap Advisor responsible for such process who shall submit monthly reports to the Governmental Entity's Governing Body. With respect to every Interest Rate Agreement, this process shall monitor the following:

1. Counterparty Credit Rating and financial condition;
2. Guarantor/Surety Credit Rating and financial condition;
3. Report of Collateral Valuation determined by the Independent Swap Advisor;
4. Report of Market/Termination Value determined by the Independent Swap Advisor;
5. Report of Hedge Effectiveness determined by an Independent Swap Advisor; and
6. Impact on Governmental Entity's financial condition and position.

I. Application and Source of Payments.

If a Governmental Entity receives a non-periodic payment in connection with entering into or performing under an Interest Rate Agreement relating to tax-exempt debt, including any termination payment, the Governmental Entity shall consult with nationally recognized bond counsel as to whether there are any restrictions on the application or investment of such payment (unless the Governmental Entity has been advised previously by such counsel that no such restriction exists). A Governmental Entity required to make any payment, including a non-periodic payment, under an Interest Rate Agreement, shall make such payment only from sources as are identified in the Interest Rate Agreement and otherwise are legally available for such payment.

J. Skill and Knowledge Requirements.

Any Governmental Entity proposing to enter into an Interest Rate Agreement is responsible for understanding the risks associated with entering into such an

Agreement. The Governmental Entity's CEO and Governing Body (through a designated member of the Governing Body and a designated member of the Audit Committee) are responsible for obtaining a basic understanding of any Interest Rate Agreement and the underlying debt. The Governmental Entity is responsible for maintaining staff able to properly understand, monitor, and disclose Interest Rate Agreements as well as hiring the necessary Independent Swap Advisors.

K. Information Sheet.

Each request by a Governmental Entity to enter into an Interest Rate Agreement shall be accompanied by a completed information sheet in the form of Appendix A attached hereto, and shall include such information as is necessary for the Comptroller to make a determination of compliance pursuant to these Guidelines.

V. GUIDELINES SPECIFIC TO FORWARD PURCHASE AGREEMENTS

A. Conditions to Entering into Forward Purchase Agreements.

Any Governmental Entity is authorized to enter into a Forward Purchase Agreement otherwise authorized by law provided such Forward Purchase Agreement:

1. Is for fixed-rate debt (with proposed continuing and one-time costs fully disclosed) with a principal amount of at least \$25,000,000; and
2. Is entered into for the business purpose of reducing the reasonably anticipated lower net cost of borrowing with respect to the debt.

B. Supporting Analysis.

Any request by a Governmental Entity to enter into a Forward Purchase Agreement shall analyze and describe how the Forward Purchase Agreement is intended to accomplish the business purpose account the various risks posed by the interest rate agreement and underlying debt. The analysis must support that the potential benefits of the Forward Purchase Agreement outweigh risks; if not, the request shall not be considered to meet the Guidelines. For a proposed debt issue this analysis shall include a comparison of all alternatives considered by the Governmental Entity and the reasons for the alternative chosen. No Forward Purchase Agreement shall be entered into unless such agreement relates to a specific identifiable indebtedness that the Governmental Entity reasonably anticipates will be issued under applicable law. The Governmental Entity must produce this analysis themselves; but, an independent financial advisor and bond counsel may be used in performing the analysis. The Governmental Entity shall have the analysis reviewed by an independent financial advisor not serving as the financial advisor for the Governmental Entity on the transaction as to the reasonableness of its methodology, assumptions, and conclusions. This

independent review shall also report on any risks not reported in the Governmental Entity's analysis and any difference on the conclusion concerning the impact of the Forward Purchase Agreement on the Governmental Entity's financial condition and position.

C. Procurement of Forward Purchase Agreements.

Governmental Entities may enter into a Forward Purchase Agreement through negotiation or through a competitive bidding process, as provided by law.

D. Form of Documentation.

The Forward Purchase Agreement shall be in the form and content similar to a standard bond purchase agreement and shall clearly define the rights and obligations of each party to the Forward Purchase Agreement in the event of failure to perform by either party. All material terms and conditions must be contained within the Agreement and not within another document.

E. Risks Associated with Forward Purchase Agreements.

Any Governmental Entity that enters into a Forward Purchase Agreement shall be responsible for understanding the risks associated with entering into such an Agreement. The Governmental Entity shall also identify those risks associated with any proposed Forward Purchase Agreement by listing and describing the risks impact in the analysis required to support the accomplishment of the Governmental Entity's business purpose.

F. Standards for Selection.

Governmental Entities may enter into Forward Purchase Agreements with any party that has a combined capital and surplus of not less than \$25,000,000 at the date of execution of the Forward Purchase Agreement. The Governmental Entity will include in its request submitted to the Comptroller evidence indicating the combined capital and surplus of such party. The Governmental Entity shall also include a copy of the latest audited financial report of such party and any interim financial reports considered necessary.

G. Application and Source of Payments.

If a Governmental Entity receives a non-periodic payment in connection with entering into or performing under a Forward Purchase Agreement relating to tax-exempt debt, including any termination payment, the Governmental Entity shall consult with nationally recognized bond counsel as to whether there are any restrictions on the application or investment of such payment (unless the Governmental Entity has been advised previously by such counsel that no such restriction exists). A Governmental Entity required to make any payment under a

Forward Purchase Agreement, including non-periodic payments, shall make such payment only from sources as are identified in the Forward Purchase Agreement and otherwise are legally available for such payment.

H. Skill and Knowledge Requirements.

Any Governmental Entity proposing to enter into a Forward Purchase Agreement is responsible for understanding the risks associated with entering into such an Agreement. **The Governmental Entity's CEO and Governing Body, are responsible for obtaining a basic understanding of any Forward Purchase Agreement and the underlying debt. The Governmental Entity is responsible for maintaining staff able to properly understand and execute Forward Purchase Agreements as well as the subsequent debt issuance. The Governmental Entity is responsible for hiring independent financial advisor(s).**

I. Information Sheet.

Each request by a Governmental Entity to enter into a Forward Purchase Agreement shall be accompanied by a completed information sheet in the form of Appendix B attached hereto and shall include such information as is necessary for the Comptroller to make a determination of compliance pursuant to these Guidelines.

History

Adopted September 27, 2000, effective October 15, 2000;
Amended July 30, 2002, effective August 1, 2002; and
Amended _____, 2009, effective _____, 2009.

Attachments

- A- Interest Rate Agreement Information Sheet
- B- Forward Purchase Agreement Information sheet
- C- Authorizing Statutes